

MINUTES OF SEPTEMBER 13, 2012 RETIREMENT BOARD CITY OF ALEXANDRIA FIREFIGHTERS AND POLICE OFFICERS PENSION PLAN DUE DILLIGENCE MEETING

PRESENT

<u>Members</u>	<u>Others</u>
Michael Cross, Participant Representative ^{3, 5, 6, 7}	Steven Bland, Retirement Administrator
Michele Evans, Deputy City Manager ^{1, 2, 8}	Barry Bryant, Dahab Associates
Pat Evans, Participant Representative Alternate ^{1, 2}	Bryan Capelli, Retirement Specialist
Tom Gates, Deputy City Manager	Dan Davidowitz, Polen Capital Management
Jean Niebauer, Director Human Rights Alternate	Ken Grimes, Herndon Capital Management
Morgan Routt, Acting Director OMB ^{4, 6}	Stan Moss, CPA Polen Capital Management
Al Tierney, Participant Representative ⁵	Marc Sydnor, Herndon Capital Management
Laura Triggs, CPA CFO, Director Finance ^{3, 4, 5, 6}	

Absent:

Shirl Mammarella ^{3, 4}

Ed Milner ^{1, 2, 6}

¹ PLOP/DROP Committee

² Purchase of Service Credit Committee

³ Technical Corrections Committee

⁴ Training Opportunities Committee

⁵ Vendor & Service Provider

⁶ Adjustment Mechanism

⁷ Chairman

⁸ Secretary

CALL TO ORDER

The meeting was called to order at 8:37 AM.

Chairman Cross mentioned the reelection to the board of Mr. Tierney and himself for terms through December 31, 2016. Ms. Niebauer was introduced as a management alternate and Mr. Gates was moved from alternate to management representative. All of these nominations were made formally Tuesday September 11, when the City Council made these appointments.

Chairman Cross said Mr. Wimer had resigned from the board.

There was a motion by Ms. Triggs to:

Accept the resignation of Mr. Wimer from the board.

Mr. Tierney seconded the motion. The motion passed (6 – 0).

Chairman Cross said the board needed a Secretary following Ms. Cheryl Orr's ending employment with the City of Alexandria.

There was a motion by Mr. Gates to:

Nominate Ms. Evans to become Secretary of the board.
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Ms. Triggs seconded the motion. The motion passed (5 – 1).

Those in favor:

Mr. Cross
Mr. Gates
Ms. Niebauer
Mr. Routt
Ms. Triggs

Those opposed:

Mr. Tierney

APPROVAL OF MEETING MINUTES

There was a motion by Ms. Triggs to:

Approve the minutes of July 13, 2012.

Mr. Routt seconded the motion. The motion passed (6 – 0).

Ms. Evans arrived at 8:45 AM.

FINANCIAL REVIEW

Staff mentioned handout 3(a) gave a high level overview of the more detailed book provided by Dahab Associates. Also, investment markets had increased substantially since quarter end.

Mr. Bryant provided the financial review. The "Risk On/Risk Off" nature of highly correlated markets continued. Most equity markets were strong in the first quarter and weak in the second. The portfolio accepts risk and therefore outperformed in the first quarter and underperformed in the second.

NewSouth was the only concern. They had underperformed from inception through June 30, 2012. Staff distributed performance results for July 1 – August 31 produced by Dahab Associates. NewSouth performed very well in that period.

Mr. Tierney asked how long it should be before the board can make an informed decision on NewSouth. Mr. Bryant said three years is the minimum. Staff said some preferred to use market cycle, which often was about three years or more.

DOMESTIC LARGE CAP INVESTMENTS

Staff distributed handout 4(a). This handout is to facilitate a comparison of the key statistics of the portfolio managers at the time of hire and today. The intent is to use the numbers as indicators of consistency or a potential change in investment style. There is no intent to manage to the numbers.

HERNDON CAPITAL MANAGEMENT

Mr. Sydnor introduced himself and Mr. Grimes. Then he provided background for the firm. Assets under management have grown. They have three portfolio managers: 1) Overseeing large and mid-cap value. 2) Overseeing large and mid-cap growth, and 3) overseeing international.

Mr. Grimes is deputy CIO and also the telecom analyst. The analysts concentrate on a sector and work for all three portfolio managers.

Mr. Grimes pointed out they have no large banks. They do have financial institutions that are service oriented. They have underweighted utilities and overweighted energy and I.T. Some holdings are in cyclical industries. Some of their largest sector weightings are:

Energy	25%
Financial	20%
Technology	10%
Consumer Staples	10%

Their focus is on what they would call Value Creating Opportunities, which is their phrase for relatively attractive Return on Equity and Price to Earnings Ratios compared to the sector averages.

The basis for not selecting big (money center) banks is because they have neither sustainable advantages nor attractive ratios.

Staff noted that telecom and utility weights are currently zero, and then asked if their weighting was always zero. It is not.

Mr. Routt asked why there was an over weighting to energy. The overweighting is due to the emerging markets. The slow-down has been built into the markets, too much so.

Mr. Bryant asked what Herndon does differently. Mr. Grimes said the difference is in how Mr. Cane puts the top ten together. Every security enters the portfolio at 1%. Very few get another 1% added.

Staff asked how they avoid value traps. Mr. Grimes said the key was to find attractiveness that would not be sustainable, such as competition.

Staff referenced handout 4(a) and asked about the change in Beta. Mr. Grimes said that was attributable to sector rotation and not cash.

Staff distributed handout 4(b), *Herndon Turnover*, and asked about buying and selling stocks in very short order. Mr. Grimes said there is a weekly sector adjustment and securities may be trimmed at any time.

The Board recessed at 10:05. The Board was called back to order at 10:10 AM.

POLEN CAPITAL MANAGEMENT

Stan Moss and Dan Davidowitz introduced themselves and Mr. Moss began with a brief overview of the firm. Assets under management have grown from \$2.5 billion when the board hired them to \$4.5 billion today. Staff asked about back office support. Mr. Moss explained they had added staff, but much was outsourced. One person was added to Finance/Accounting Compliance and a director of operations will be on board by year end.

The firm's founder, David Polen, passed earlier this year. Mr. Moss said they recently researched the impact of this. Of the last seventeen securities purchased sixteen had been first recommended by Mr. Davidowitz or an analyst Mr. Ficklin.

Referring to the presentation booklet:

Page 2 displays performance and ranking over periods from one to twenty years.

Page 3 shows they are running concentrated portfolios. They focus on securities of companies that they expect there will be a significant increase in earnings with little change of price to earnings ratio.

Page 7 displays attribution analysis. Over the long haul their outperformance is attributable to stock selection, and not sector selection.

Page 9 they discussed Coach and CH Robinson. They believe Coach is slowly losing its competitive advantage.

Mr. Tierney asked about Abbott Labs which is splitting into two companies. Mr. Davidowitz explained he likes the diversified medical company and its management. He is not as comfortable with the pharmaceutical company because it is very heavily dependent on one drug, Humira. The financial structure of the split has not been determined.

PANEL DISCUSSION

The representatives of both Herndon and Polen discussed Apple computer and Coach. They discussed value vs. growth. They discussed valuation and how a company is analyzed.

Dan Davidowitz said unique perspective is more important than unique information. Classification of growth versus value is often done by valuation. Instead, it ought to be done by permanence of earnings growth.

Ms. Niebauer asked about social screens. Mr. Grimes said that tobacco company lawsuits were an issue. Mr. Davidowitz said they have no tobacco companies and no pay day loan companies.

Staff asked about capital structure. Mr. Davidowitz seeks a pristine balance sheet, including cash and little debt. This includes companies like Oracle and Abbott Labs, who are also good at mergers and acquisitions.

The board went into recess for lunch at 11:30 AM and resumed the meeting at 12:01 PM.

FUTURE AGENDAS

Chairman Cross discussed the many topics that would come to the board in future meetings. Mr. Tierney asked about the RFI for Administration. The RFI is complete and it demonstrated in house administration is preferred.

Some requested future board retreats in January. Some saw that as a conflict with the budget process. June or July may be better.

Meetings might tentatively be set for the second Thursday of the month. Mr. Bryant will check his calendar and staff will reserve rooms.

Staff referred to handout 5(b), *Growth of the Fund*. Staff used several methods to demonstrate the fund will be significantly larger ten years from now. An excerpt from a prior Cheiron presentation did collaborated the projections.

Staff distributed handout 5(c). This handout built on handout 5(b) by suggesting that allocation such as timber may have an appropriate commitment the day an RFP is issued but before the investment runs its term it will be significantly under allocated.

Staff referenced handout 6(e)(iv), Farmland returns. This sheet displayed returns of the underlying real estate of farmland and not the rental value or the crop production.

Staff concluded with a recommendation to facilitate the RFP process and adding follow on investments in timber, farmland, and private equity over a period of time. Staff will work with Mr. Bryant and the Chairman to bring a proposal to the November meeting.

Ms. Triggs said she would review the Dahab contract to determine if a new RFP is needed.

ADMINISTRATOR'S REPORT

FOLLOW UP ITEMS –

Election: (taken out of order)

The Board reviewed handout 6 (e)(i).

There was a motion by Mr. Tierney to:

Revise the Board election procedures by adopting Option A of handout 6 (e) (i).

Ms. Evans seconded the motion.

Discussion: The Alternate seat should be advertised as a contingent election. If Mr. Evans were to seek the Participant representative position but not win that election, he would retain the Alternate position.

The motion passed (7-0)

Ms. Triggs made a motion to:

Enter executive session.

Ms. Evans seconded the motion.

The motion passed (7-0). The Board entered executive session at 1:25 PM.

The Board exited executive session at 2:32 PM.

Ms. Triggs made a motion to:

Mister Chairman, I move that the Board adopt the following resolution:

WHEREAS, the Alexandria City Fire Fighters and Police Pension Plan Board has this 13th day of July, 2012, recessed into closed executive session pursuant to a motion made and adopted in accordance with the Virginia Freedom of Information Act; and

WHEREAS, § 2.2-3712 of the Code of Virginia requires a certification by the Board that such closed executive session was conducted in accordance with Virginia law;

NOW, THEREFORE, BE IT RESOLVED that the Board does hereby certify that, to the best of each member's knowledge, only public business matters that were identified in the motion by which the closed executive session was convened, and that are lawfully exempted by the Freedom of Information Act from the Act's open meeting requirements, were heard, discussed or considered by the board during the closed executive session.

Ms. Evans seconded the motion. The motion passed (7-0).

ICMARC: (taken out of order):

Handout 6(e)(iii) was discussed.

Mr. Tierney made a motion to:

The annual administrative fee should be \$58 per person plus an amount sufficient to raise \$25,000 annually for the investment consultant's fee.

Ms. Evans seconded the motion.

Discussion: \$25,000 spread over all plan participants will be roughly \$12 per person annually.

The motion passed (7-0).

Mr. Tierney made a motion to:

Execute a task order for Dahab Associates \$25,000 annual fee for review of the defined benefit and defined contribution plans.

Mr. Evans seconded the motion.

The motion passed (7-0).

Mr. Tierney made a motion to:

Execute a contract with ICMARC.

Ms. Evans seconded the motion.

The motion passed (7-0).

A City-wide committee should be formed to provide feedback to Mr. Bryant and staff in the design and communication of the defined contribution and deferred compensation investment platforms. The committee members should be Jennifer Harris, Mr. Tierney, Mr. Evans, and Jean Niebauer. Mr. Bryant will chair the committee.

ADMINISTRATOR'S REPORT

REGULAR INVESTMENT REPORTS

Investment and Rebalancing Report

The report was reprinted to reflect significant new data that was available for timber. Rebalancing the disability component to increase mid cap will probably be appropriate in November.

Cash Flow Report

Handout 6(a)(ii) was referenced. On Part 1 the large disbursement was attributable to a DROP payment. Typically contributions exceed benefits and expenses. On part 2 it was noted that the cash flow report was corrected in prior periods for including previously omitted one or two distributions from private equity. The cash flow deficit was smaller. The deficit was due to half of timber commitment being called between May and July. The deficit should be smaller by year end. It is likely the plan should be cash flow positive next year.

Private Equity

Staff referenced handout 6(a)(iii)(1) and (2). Calls and distributions were nearly offsetting. The Hamilton Lane Secondary Fund II has had over 82% of its commitment called to date. The primary fund is much less mature.

Timber

The fund has had 100% of its commitment called as of July 7, 2012. Handout 6(a)(iv) indicated that the growth in timber land had been modest or negative the last four years.

Volatility Report

The report implied the domestic equity markets are not ready for a fall as of last month end.

COMMUNICATIONS/SEMINARS/CONFERENCES and TRAINING

Information on IFEBP conferences was available with the handout materials.

Mr. Evans arrived at 1:15 PM.

PLAN DOCUMENT RESTATEMENT

This topic was not covered.

RFP KEN HOFFMAN/VENABLE

This topic was not covered.

FOLLOW UP ITEMS (Continued)

Allocating expenses:

Staff distributed handout 6 (e) (ii). Certain expenses, such as the fee for the investment consultant, are prorated in proportion to plan assets. The asset levels change so periodically the ratios are updated.

ICMARC:

Farmland:

Farmland was discussed in the context of item 5.

Demographic Update:

Staff referenced handout 6(e)(v). Ms. Evans requested disabilities by year are added to the handout.

ASSET ALLOCATION

This topic was not covered.

QUALIFIED DOMESTIC RELATIONS ORDERS (QDROs)

This topic was not covered.

COMMITTEE REPORTS

Adjustment Mechanism Committee:

Handout 7(a) was distributed. Ms. Triggs reported on the committee's progress. In 2004 the employee's share of the total pension plan contribution was 26%. In fiscal year 2013 the employee's share of the total pension plan contribution is 21%. The committee has discussed a contribution rate sharing mechanism that calls for the employee to contribute between 21% and 26% of the total pension contribution. These bounds are illustrated on page one of the handout.

The committee discussed a possibility of lowering benefit accruals if contributions got too high. When total contribution rates came down the employee would resume contributing their share in full and the benefit accrual rate would increase prospectively. This is the subject of page two of the handout.

The third page of the handout includes a list of next steps. The committee is scheduled to meet September 20, 2012 to review the list of next steps and any feedback from the Board.

Chairman Cross had spoken to the fire department employee associations to let them know about City Council's direction.

Ms. Evans would like to see more people involved in the discussion. This is part of the Next Steps (page three of the handout). She also said Fairfax has lowered benefits for new hires.

PLOP/DROP Committee:

This committee did not report.

Purchase of Service Credit:

This committee did not report.

Technical Corrections Committee:

This committee did not report and leaves of absence in the calculation of the average monthly compensation were not reviewed.

Training Opportunities Committee:

This committee did not report.

OLD BUSINESS

UPDATE: RISK MANAGEMENT OVERSIGHT COMMITTEE

Ms. Triggs began with a history of Workers Compensation cost increases. The Mayor has regularly asked about these increases. In 1996 Fairfax County increased benefits for the most seriously injured and decreased benefits for more minor injuries in which case the employee typically gets another job.

Chairman Cross left at 3:15 PM.

Tom Gates asked if the Board committee was the appropriate committee to act as the communication resource.

Mr. Tierney made several comments about management's disability management proposal. ~~City code Part II, Title 2, Chapter 4, Article A, section 2-4-5 (a) may need some discussion.~~

Ms. Evans would like to see how the City is positioned relative to its five comparators.

The RFP for the defined contribution provider was discussed during Mr. Bryant's comments in the Financial Review.

NEW BUSINESS

SUPPLEMENTAL RETIREMENT BOARD

This topic was not discussed.

NEXT MEETINGS

There will be an interim meeting October 11, 2012 at 8:30 AM.

ADJOURNMENT

The meeting adjourned at 3:28 PM.

Handouts distributed in advance

The materials included in this mailing are:

- Agenda
- Minutes of July 13, 2012 [2a]
- Financial & Economic Review [3(a)]

- Domestic Large Cap Equity Overview [4(a)]
- Projecting Fund Growth [5b]
- Monthly Investment & Rebalancing Report [6(a)(i)]
- Cash Flow Report [6(a)(ii)]
- Private Equity Cash Flow Report – Hamilton Lane Secondary [6(a)(iii)(1)]
- Private Equity Cash Flow Report – Hamilton Lane Primary [6(a)(iii)(2)]
- NCREIF – Timberland Returns [6(a)(iv)]
- NCREIF – Real Estate Returns [6(a)(vi)]
- Administrator’s Follow-Up Item - Allocating Expenses [6(e)(ii)]
- Administrator’s Follow-Up Item - Farmland [6(e)(iv)]
- Demographic Update [6(e)(v)]
- Asset Allocation [6(f)]
- Dahab Performance Review June 30, 2012
- Prudential Investment Second Quarter 2012

Handouts distributed during the meeting

1. City of Alexandria – Defined Benefit Plan – Preliminary Performance Periods Ending August 31, 2012
2. Herndon Capital Management
3. Herndon Turnover – 4(b)
4. Polen Capital Management
5. Getting it Right, Setting Allocations in Alternative Assets - 5(c)
6. Future Board Meeting Agenda Items - 5(e)
7. Monthly Investment & Rebalancing Report – revised - 6(a)(i)
8. Follow Up Report September 13, 2012 - 6(e)

9. Retirements By Year – 6(e)(v)
10. Volatility Report – 6(a)(v)
11. ICMARC Sample Pricing Options – 6(e)(iii)
12. Memorandum to Rashad Young from Ms. Triggs, Proposed Changes to Disability Benefits Provided Under the Firefighters and Police Officers Pension Plan and Other Safety, Health, and Wellness Practices – 8(a)